

Refinancing State and Local Government: A View from Ground Zero

Matt Smith

Commissioner, MN Department of Revenue

Multistate Tax Commission
“Federalism at Risk” Dialogue
Bismarck, ND July 26, 2001

MN state and local own-source revenues

- personal income tax 22%
- property tax 20%
- fees and charges 18%
- sales taxes 15%
- other taxes 15%
- other revenues 10%

FY00 “Price of Government” data

Who pays the tax bill...

- **MN households pay 63%** of total taxes
 - 84% of income taxes, 56% of consumption taxes, 46% of property taxes
- **Businesses pay 34%** of total taxes
 - 13% of income taxes, 38% of consumption taxes, 54% of property taxes
- **Nonresidents pay 3%** of total taxes
 - 3% of income taxes, 5% of consumption, 1/2% of property taxes

(Tax incidence study, 1998 tax year)

... and who bears the tax burden?

- **Households ultimately “pay” all taxes** via higher prices, or lower wages or capital returns
- **16% of total taxes exported** to non-MN households
 - 57% of business property tax, 50% of corporate income tax, 30% of gas tax, 18% general SUT, 4% personal income tax
- **Overall MN state and local tax incidence is roughly proportional to income**

(Tax incidence study, 1998 tax year)

18 months of statewide meetings, interviews, study groups:

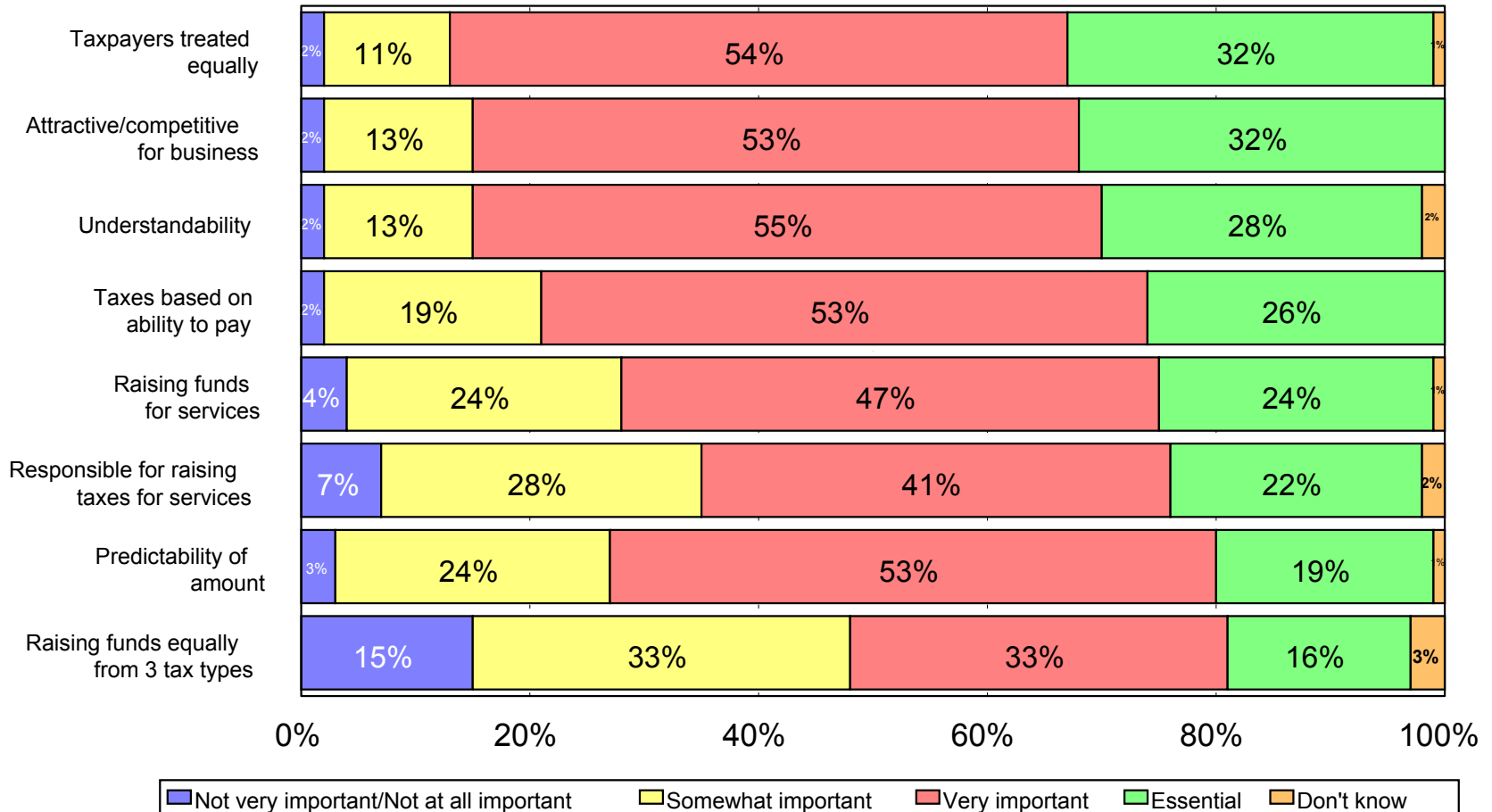
“No crisis, but concerns”:

- Fairness is number one
- Complexity of the tax and spending systems
- Uncertainty/insecurity about the future
- Competitiveness and long-run growth

Equal treatment, attractive/competitive business environment, and understandability top statewide poll

Importance Of Tax Issues To Minnesotans

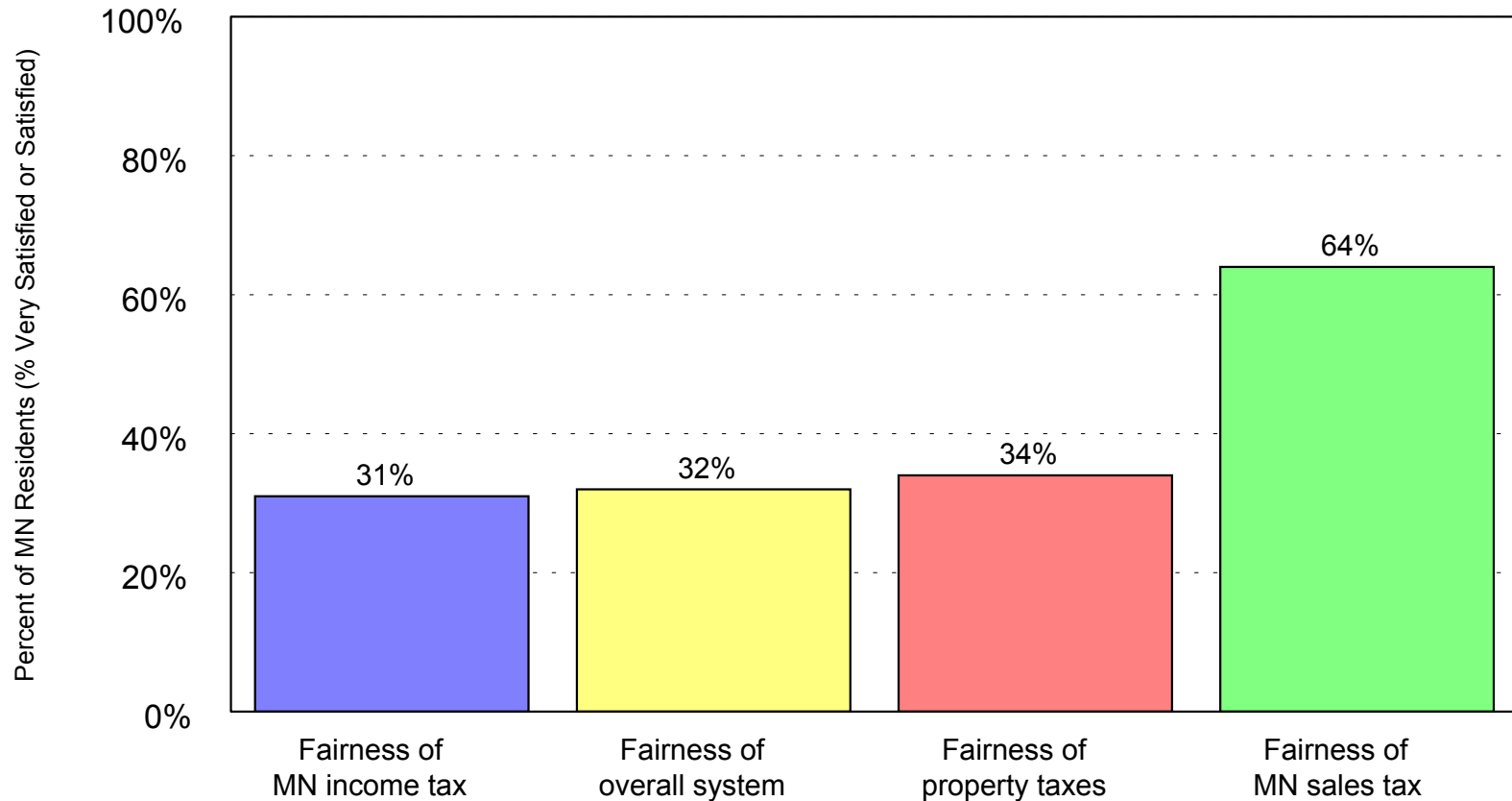
(N = 400)



Sales tax rates far better than other major taxes in terms of equal treatment for taxpayers

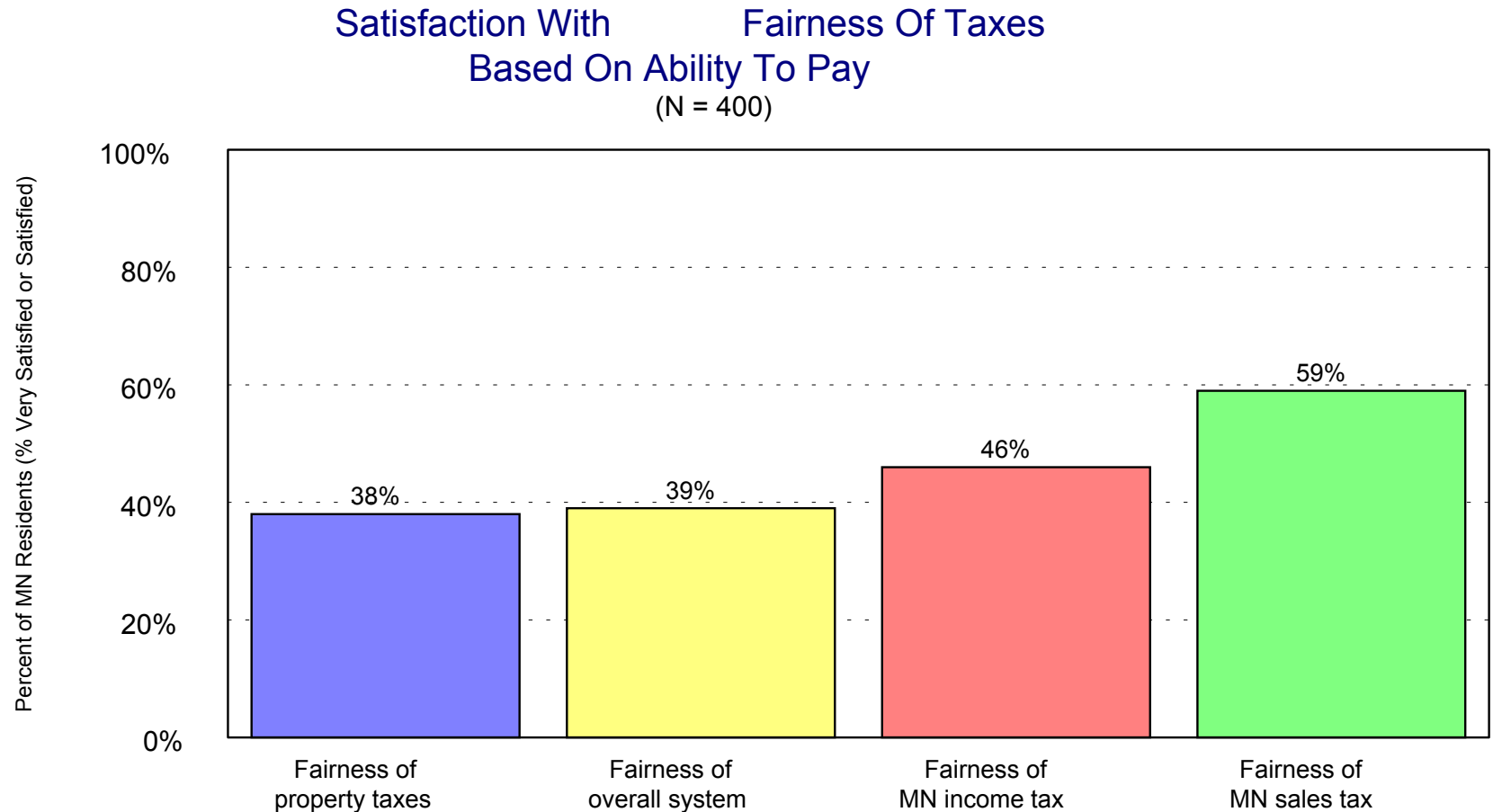
Satisfaction With Fairness Based On Extent To Which
Taxpayers Are Treated Equally

(N = 400)

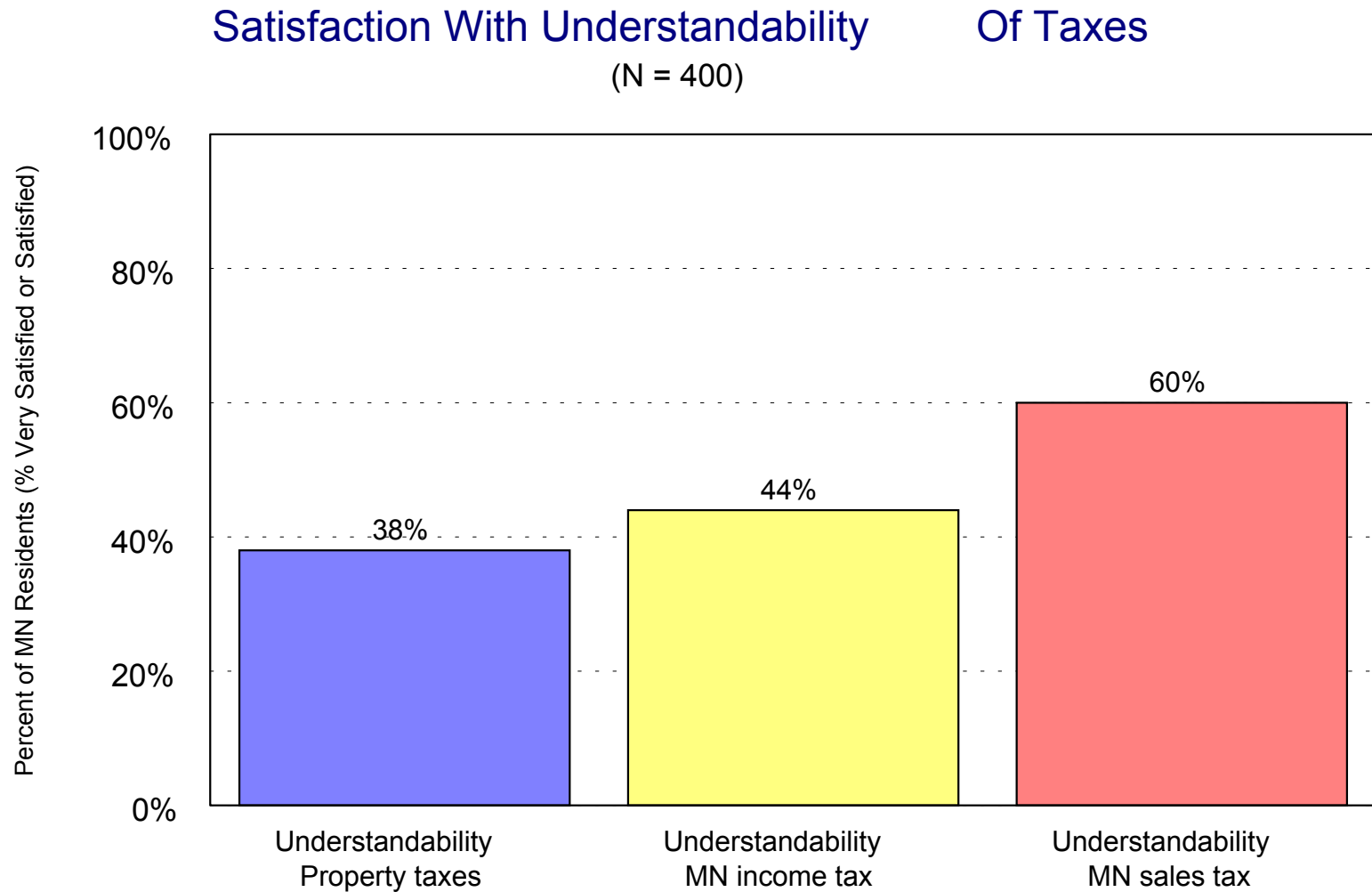


Taxpayers find sales tax most fair, property tax least in terms of ‘ability to pay’

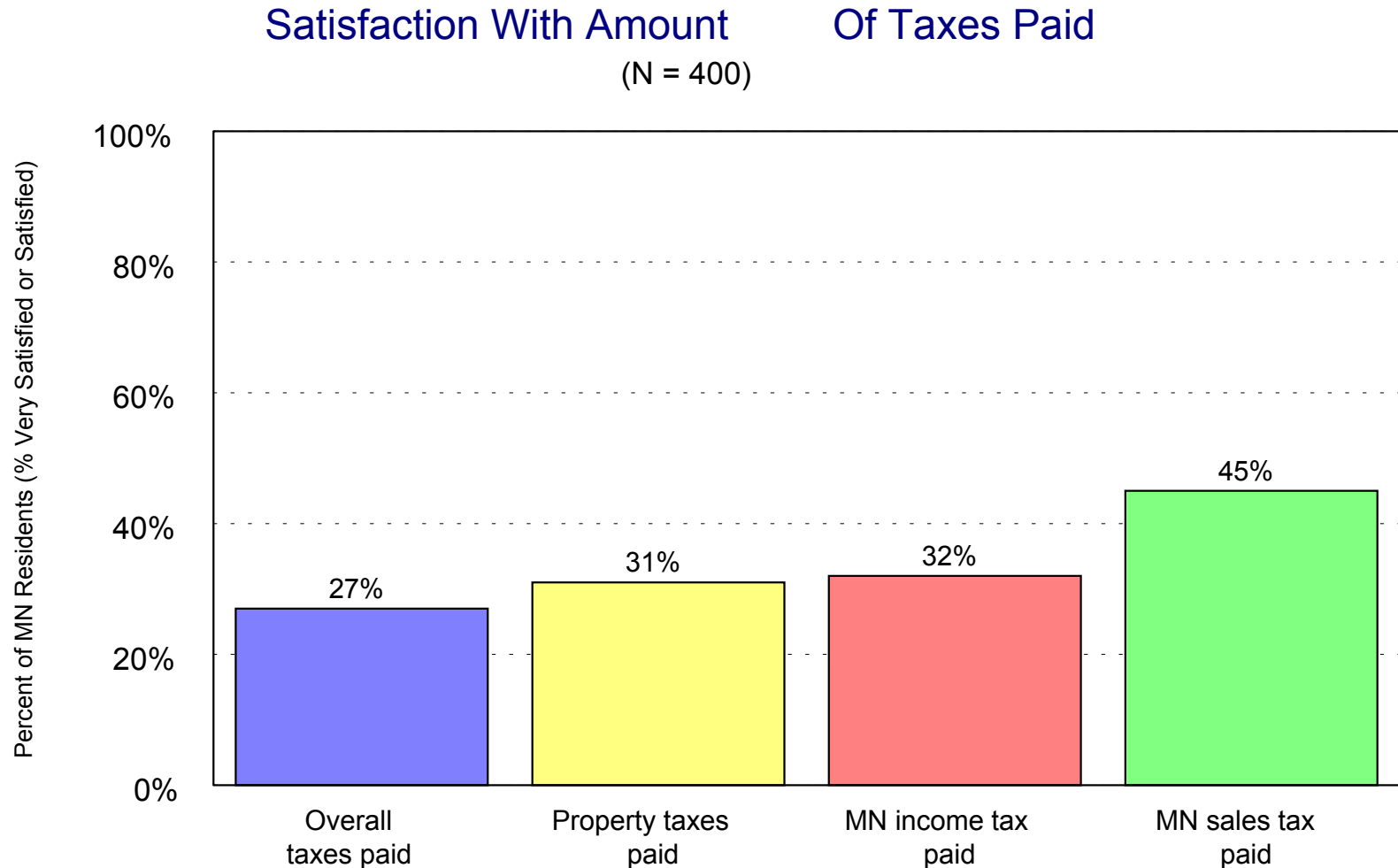
FIGURE 8



Taxpayers rate sales tax most understandable



Taxpayers least dissatisfied with amount of sales tax paid



Tax Reform Goals:

- Property tax smaller, simpler, and more local/accountable
- Sales tax applied more uniformly to fairly reflect modern service economy and technology
- Improve competitiveness via business/rental housing tax relief and income tax cuts
- Couple reform with net relief



“Big Plan” Tax Reform

2001 Legislature

- Full state funding of basic K12 costs--no residential property tax not voted on
- Property classification and local aid restructuring
- Sales tax modernization and reform (base up, rate down, NSST)
- Income tax reductions



What happened?

- Acknowledged as a bold, well-prepared proposal by press and experts
- Sales tax base expansion foundered on combination of budget surplus and interstate competitiveness concerns (but did get SST)
- Income tax cuts fell off due to lack of sales tax reform and slowing economy
- Property tax reform enacted as proposed-- but only after special session brinksmanship

Where next for MN tax policy?

- Need for sales tax reform/modernization is more widely acknowledged--"a matter of time?"
- "Basic" school funding now entirely dependent on state revenues--so more share a stake in the viability of state taxes?
- New statewide business property tax is nearly as big as the corporate income tax--so tradeoffs are now more direct and visible

Thanks!

www.taxes.state.mn.us